

MICROENTERPRISE LENDING PROGRAM
WEST BANK AND GAZA

FIRST ANNUAL PROGRESS REPORT
WITH THE FOURTH QUARTER PERFORMANCE MONITORING REPORT FOR 1998

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ACRONYMS

ABA	Alexandria Businessmen's Association
FLO	Field loan officer
LTS	Loan-tracking system
MIS	Management information system
NGO	Nongovernmental organization
PB	Participating bank
PMA	Palestinian Monetary Authority
RA	Resident advisor
SLO	Supervisory loan officer

EXECUTIVE SUMMARY

This report includes the fourth quarter monitoring report for 1998. The requirements for the annual progress report include extensive financial information on the number and value of the loans, repayment rates and delinquencies, income and expense reports highlighting operating costs, and a summary of sources and uses of funds. Therefore, a Portfolio Growth and Loan Quality section and a Financial Performance section have been included here. The borrower profile information required is covered in the Research and Evaluation section.

Project implementation started in January 1998 with an institutional diagnostic, establishment of the Chemonics field office, and arrival of the resident advisor. Memoranda of Understanding between the participating banks and the Chemonics team were also negotiated and signed during the first quarter. Field loan officers were hired and started work at the end of March. After training field loan officers and final agreement with the participating banks on program design (pricing, geographic cover, etc.), lending began in June at Arab Bank and Bank of Jordan.

From June until year-end, the banks disbursed a total of 756 loans totaling \$1,584,820. Arab Bank disbursed 309 loans totaling \$694,399; Bank of Jordan, 447 loans totaling \$890,421. During the fourth quarter, the banks made 368 loans with a value of \$825,485. As of December 31, 1998, there were 627 outstanding loans totaling \$870,692.

Loan quality during 1998 was very high. As of December, only one loan (totaling \$1,333) was more than 30 days past due.

These are impressive results, even though the volumes are below the originally planned level. Incentives, faster processing of loan approvals after the first cycle, and improvement in approval practices should speed growth of the portfolio in 1999.

The banks are starting to see the profits needed to convince them that the microloan business is sustainable and should become a standard bank product. After USAID payments, all branches made profits on the microloans each month in the fourth quarter, and both banks are nearing breakeven. This has happened even though loan volumes and interest income have been much lower than projected because program expenses at the banks have been substantially lower than expected — \$160,319 less for Arab Bank and \$253,199 less for Bank of Jordan. The recent strong action by Arab Bank management to solve many issues that slowed the development of the project may be one indication of the impact of these financial results.

USAID payments covered 81 percent of Bank of Jordan microloan program expenses and 47 percent of those for Arab Bank. These figures do not include the cost of the support, technical assistance and training provided by Chemonics.

EQI finished installing the management information system (MIS) at Bank of Jordan in the fourth quarter under USAID contract. Arab Bank has modified its systems, but its MIS staff still have not completed all the reports required. This lack of essential information on loan status increases the difficulty of identifying and acting on possible problem loans. Getting full reporting functionality may continue to require substantial persuasion from the Chemonics advisors. Spreadsheet-based planning and performance reporting models were also developed in 1998 and are being modified by a

consultant for use in 1999.

There was much research and evaluation activity in the fourth quarter. An internal evaluation of the project was made in November, and its recommendations are in the Recommendations for Participating Banks section of this report. A baseline market survey was completed in May and a second survey, assessing the profile of the microenterprise borrower, was done in November. Both the evaluation and surveys show that the program is on target but that some modifications are needed.

Included in this report are the performance monitoring reports and a schedule of activities from the Year 1 Implementation Plan and their status (see Annex B). The Year 2 Action Plan is delayed, as agreed, until the new resident advisor is in place, but a summary of planned activities for the first quarter are presented.

ANNUAL PROGRESS REPORT AND QUARTERLY REPORT

A. Introduction

A1. Background

The USAID Microenterprise Lending Program, a two-year, cost-plus-fixed-fee completion contract, is designed to provide a sustainable source of formal credit to microentrepreneurs by assisting two commercial banks, Arab Bank and Bank of Jordan, acquire and apply “best practice” microlending techniques. The program provides technical assistance and training as well as assistance in MIS development and installation. Chemonics works with the participating banks to introduce and incorporate new lending techniques and modify procedures, in keeping with the best practices in microfinance, namely:

- Information-based lending emphasizing close and continuing personal contact with borrowers and meeting their needs with loans, savings accounts and other services.
- Incentives to the borrower and lending staff for on-time repayment.
- Simple documentation and simple loan approval and processing procedures to make borrowing easier and to cut cost.
- Setting interest rates high enough to make the program profitable and sustainable.

A2. Objectives

The objectives of the program are as follows:

- To leverage USAID financial inputs with substantial capital from the participating banks to reach much greater numbers of microenterprises than can be reached through NGO-financed programs.
- To enhance the potential for rapid scale-up in the number of microloans and cumulative value of these loans in order to assist the banks achieve early profitability.
- To achieve a system of microfinance through the commercial banking sector, whose microcredit will have greater prospects for long-term financial and institutional sustainability than that of traditional NGOs.
- To provide microentrepreneurs access to a wider range of banking services and develop a long-term relationship between the banks and microentrepreneurs.

A3. Expected Results

The expected results are as follows:

- Bank of Jordan and Arab Bank each will have made at least 1,000 new microenterprise loans with a total portfolio of at least \$2.5 million after 18 months.

- Both will be capable of managing the loan portfolio identified above.
- At least one of the banks will have decided to make microenterprise loans a continuing service at the conclusion of the contract.
- The microenterprise lending programs of both banks will be self-sustaining at the conclusion of the contract; that is, they will operate at a financial breakeven point or better.
- Chemonics will achieve these results by providing ongoing resident technical assistance and training, coordinating short-term technical assistance and training, recruiting and employing up to 10 field loan officers (FLOs) per bank branch, procuring and installing a management information system, and providing research and evaluation services.

B. Performance for the Year

This section focuses on Quarter 4, October 1 through December 31, 1998.

B1. Institutional Contractor Office Activity

The founding resident advisor, Philip Broughton, resigned from the project November 27, 1998. Chemonics continues to search for his replacement. A deputy resident advisor, possibly a Palestinian, has now been authorized, and Massar Associates has initiated a search to identify good candidates.

With the planned expansion to Gaza, the type and level of office support needed will be explored during the coming quarter.

B2. Field Loan Officers and Supervisory Loan Officers

B2a. Employment and Recruitment of FLOs

Nineteen FLOs are currently employed under the project and working in the following branches:

<i>Bank of Jordan</i>		<i>Arab Bank</i>	
Nablus	5	Al Bireh	5
Hebron	<u>5</u>	Bethlehem	<u>4</u>
Total	10	Total	9

One FLO left Hebron in October and has not been replaced. In addition, an FLO at Al Bireh was absent in December and may be replaced. Recruitment for a sixth FLO for Nablus, Hebron and Al Bireh is planned for the 1999 stage II expansion. However, these three new FLOs may not actually be hired unless loan volume grows substantially or an FLO leaves the program. No additional FLO is considered necessary in Bethlehem now.

Stage II recruitment will take place in the first quarter of 1999 to staff new Bank of Jordan units in Jenin and Gaza. In late December, Massar Associates started the recruitment process.

B2b. FLO Incentive System

The modification in the FLO incentive system, proposed last quarter to encourage increased production, has been approved by both banks. It will not be implemented until February, after Ramadan. Incentives are paid based on two factors, loans disbursed and repayment rate, with the emphasis now shifting to loans disbursed; however, the repayment rate is still strongly weighted.

The most effective way to increase production is to create positive incentives for the FLOs to make more loans. On average, FLOs are managing 25 to 50 loans and disbursing less than 6 per month when they should be managing 120 or more and disbursing 15 or more per month (including new and repeat clients). During the fourth quarter, the number of loans disbursed per FLO each month hardly grew at all, except in Nablus. With repeat loans being made to borrowers, this number should increase during the next quarter. Total loans will continue to grow since there will be more new loans made than loans fully paid, but the incentives are also needed.

B2c. Supervising Loan Officer Incentive System

In the interest of increasing volume (and profit) while maintaining quality, an incentive system for supervising loan officers (SLOs) also was proposed to the banks. Bank of Jordan's regional management very strongly supports this proposal and has asked for approval from its general management in Amman. The assistant general manager for the region has said that he is lobbying heavily for approval and will keep trying if it is not initially given. Arab Bank, however, has said that it cannot support the proposal because it would be in conflict with its personnel policies.

C. Technical Assistance

During the first three quarters of 1998, in addition to training, MIS activity, and evaluation and survey work, there were a number of short-term consultancies. In January consultants Doug Villepique and Everett Post conducted an institutional diagnostic of the policies and procedures for the participating banks, and made recommendations on ways to implement the project at each one. They also developed a model to produce a draft financial plan. In the second quarter, Mr. Post refined the planning model he created in January, developed an interim model for the performance monitoring report, and helped gain agreement between the banks on loan pricing, geographic coverage and future coordination.

Also in the second quarter, consultant Karl Jensen guided the FLOs at each of the four branches in the start of lending, and the resident advisor, with help from a Palestinian consultant from Jordan, created a Microenterprise Lending Unit Operating Manual and loan documentation.

Technical assistance in the third quarter was limited to an important senior management workshop, during which Bill Tucker guided the managers in a discussion of microfinance best practices related to project implementation. A training graduation ceremony for the FLOs, attended by bank officials and the USAID deputy mission director, also took place at the workshop.

C1. Fourth Quarter Consultancy

Mr. Post provided 12 days of service in December to continue implementation of the program in the absence of the resident advisor. He focused on the recommendations of the internal evaluation and revising the business plans for 1999. His work also included revising the planning model and the performance monitoring system. Mr. Post will return in January to help bridge the gap until the new resident advisory team is in place.

C2. Microenterprise Lending Unit Operating Manual

The planned revision and update of the Operations Manual for this quarter has been postponed until the new resident advisor is in place. Loan operations methods and procedures continued to be based on the original manual, with advisory assistance from Chemonics. Short-term consultant Ignacio Alvizo, in conjunction with his candidacy for the resident advisor position, provided advice on practices in Nablus. Chemonics specialist Jorge Daly's evaluation resulted in much more extensive comments on lending policies at both banks.

C3. Microenterprise Forum

There was no activity in the fourth quarter on this issue. Development of the Microenterprise Forum will be a responsibility of the new resident advisory team.

C4. Program Development and Assistance

In the first half of 1998, the program's start-up year, most efforts were spent on project preparation at the banks and gaining their agreement on the policies and procedures for implementation. With the hiring of FLOs and designation by the banks of the SLOs, the program took physical shape. Loan policies were agreed to in May and lending began in June. Both banks were conservative in their approach to this new business and reluctant to introduce immediately all the best practices recommended. Their stringent guarantor requirements and bureaucratic and hierarchical approval and disbursement processes (particularly at Arab Bank) slowed productivity through the early quarters.

The fourth quarter was one of transition. Management information systems were mostly in place. Lending staff members were trained and experienced. The resident advisor left the project. The first loans were fully repaid, and the first second-cycle loans were made. The branches made their first profits, and plans were made to expand to new branches in Jenin and Gaza.

The quarter was also a period of forming lending procedures more in line with best practices, with the changes at Arab Bank especially dramatic.

There have been significant differences in where this program is managed within each bank and in the background of the managers responsible for implementing it. These differences have affected the way the program has developed at each bank.

C4a. Bank of Jordan

At Bank of Jordan, the microloan program is the responsibility of the credit manager for the West Bank and Gaza, Susan Khoury, a highly experienced credit officer from Amman. She attended USAID seminars on microenterprise credit long before the current program started and quickly understood how microloan best practices work and the potential for them. She and her supervisor, assistant general manager Atiyey Shananier, have been enthusiastic about the microloan project. Mr. Shananier is now a strong advocate within his bank for the microloan business. Top management in Amman have made him responsible for reviewing the bank's participation in the new USAID project in Jordan, Access to Microfinance and Improved Implementation of Policy Reform. Deputy general manager Aziz Shaker also is backing the program. Moreover, all three bank officials are strongly supporting the recommendation to general management in Amman that SLOs be given incentive pay. This is a major change in the type of compensation given that level of bank employee. The bank is also smaller and less bureaucratic than Arab Bank, resulting in easier decision making.

Since January 1998, Bank of Jordan has been very cooperative with Chemonics in developing the program and sharing views with the resident advisor and program consultants. Mrs. Khoury was deliberately conservative at the start of the program to ensure that it started without problems and generated an excellent track record. Loan approval has always been fast and is getting faster, and processing steps have been simplified. Guarantor requirements exist but are relatively simple, as supported both by discussions with lending personnel and the recent borrower survey.

Especially at the Nablus branch, loan volume has grown well, though less than planned. The bank is now preparing to expand the program to its branches in Gaza and Jenin, and is planning to pay the FLOs at Jenin itself, without USAID funds. All four of the bank's branch managers, plus the three members of regional management, will attend the senior management exposure trip to Chile, and management is enthusiastically discussing ways to integrate FLOs into its regular bank staff.

In short, Bank of Jordan is progressing well in program development management, and is primarily faced with the challenges of success and expansion. It is the more likely of the two banks to continue the program after USAID funding ends.

C4b. Arab Bank

Arab Bank is much larger and more conservative than Bank of Jordan, making it more difficult to implement new, untested programs. However, a successful program at Arab Bank would have a major impact because of its size and leadership within the West Bank and Gaza banking community.

Joseph Nesnas, vice president of Institutional and Private Banking and manager of Public Relations, manages the microloan program, as well as programs serving microenterprise credit programs in the West Bank and Gaza and an International Finance Corporation small/microloan program for loans of \$10,000 and above. He recently joined Arab Bank after many years working on USAID projects as an employee of ACDI. Mr. Nesna is supported by Nader Ackall, who returned from working for a consumer finance company in the United States just before the program started. As relative outsiders at the bank and not part of its career loan officer staff, both men have had a more difficult time than their counterparts at Bank of Jordan in developing the program.

The resident advisor and the recent evaluation both expressed concerns about the effect of the bank's less flexible lending practices on portfolio growth. The approval process has been quite slow and the requirements, especially for loan guarantors, have been very stringent.

There are other issues still to be resolved. Neither of the SLOs has been committed 100 percent to the project, and the management information system being developed by Arab Bank specialists is far behind schedule in producing required reports. The bank's management has said that it cannot accept the proposal for SLO incentives and that its managers will not be able to participate in the senior management exposure trip to Chile.

Recently, the management made significant changes in the bank's development of the microloan program, and the loan approval process is being significantly speeded. Loans needing a decision on approval are no longer being sent to regional management in batches, but instead are sent individually as they are ready. Now, only two members of the Regional Management Loan Committee must meet to approve a loan, instead of the full committee. However, the other members must still initial each approval request to show their agreement; reportedly this process is becoming more routine, with the committee rubber-stamping a branch's approval. Second and subsequent loans will have even faster approval decisions.

Mr. Nesnas had the bank's lawyers develop an easy-to-complete loan contract that is now being used for the program, and he hopes to get the guaranty requirements relaxed as the loan performance at both Al Bireh and Bethlehem continues to be good. He has also met with all the Arab Bank FLOs and SLOs to discuss these changes, encourage them to build business, and listen to their concerns. The bank has now approved the FLO incentive plan. Mr. Nesnas has also promised to take strong action to end the delay on MIS development and has asked for compensation to cover the cost of MIS work done so far.

Recent comments indicate that the bank is reacting competitively to the relatively better performance of Bank of Jordan. It was reported that senior management would be upset if Bank of Jordan expands its microloan program and Arab Bank does not. There has also been good reaction to the fourth quarter profits that the branches have shown on an after-USAID-payment basis. An excellent indication of the effect of the financial results is that Mr. Nesnas had a special summary of the financial performance reports prepared for him to present at the bank's regional management meeting in November.

Arab Bank has significantly improved development of its microloan program and has moved closer to best practices. However, there is still significant work to be done. Chemonics and the USAID COTR will both need to continue monitoring the situation closely and provide maximum assistance and persuasion to the bank's management.

D. Training

In the second quarter, Chemonics implemented a training program for the new FLOs designed by the resident advisor. It included an introduction to banking and to the bank and, later, bank internships. Bank experts served as trainers: Nabil Elshami from the Alexandria Businessmen's Association (ABA) in Egypt taught principles of microenterprise lending; and two consultants from ShoreBank Advisory Services, supported by Mazen As'ad from Massar Associates and Kholoud Khaldi from Jordan, taught business, credit and cash flow analysis. Finally, as lending began, the resident advisor with help from consultant Karl Jensen conducted a lending unit procedures review.

The next formal training activity was in December, when the first of two groups of FLOs and SLOs participated in a one-week training session at the microenterprise loan program of the ABA in Egypt. This training exercise differed from previous ones in that the primary focus was field operations and, for SLOs, field operations management. Amr Khilfer, Massar finance and administration specialist,

accompanied the group to provide support and gain exposure in working with the ABA's experienced administrative and financial staff. The second group is scheduled to leave for Egypt on February 5, accompanied by Rasha Kassis, Massar project assistant.

More progress was made in planning a senior management exposure trip to Chile to meet with commercial banks implementing innovative and profitable microfinance programs. As the original January 1999 dates for the trip conflicted with the peak summer vacation period for Chileans, the trip is being rescheduled. Official invitations were sent to both banks in November. Arab Bank has advised Chemonics that it will not be able to participate, but Bank of Jordan plans to send all its four branch managers, Mrs. Khoury, Mr. Shananier and Mr. Shaker. The management wants to be in Chile during holidays if possible because their bank will be closed and will suffer less from their absence.

In December, Massar Associates started a project to consolidate training materials and prepare a training curriculum and plan for training new FLOs. The project report will help the new resident advisor and deputy resident advisor organize a training program for new FLOs and allow them to build on the previous program and use the experience of the branches already implementing the project.

E. Management Information System

Developing a management information system for the project has been a major activity. As the result of a systems diagnostic completed by Chemonics consultant Peter Glibbery before the end of the first quarter, both banks made changes. Arab Bank decided to modify its computer system, which had been used for a Cooperative Housing Foundation loan project. Bank of Jordan decided to install a stand-alone system to manage its microloans. For Bank of Jordan, Chemonics would have the Egyptian firm, EQI, modify its loan tracking system, which had been derived from a system used by the ABA microloan project.

In the second quarter, Mr. Glibbery returned to devise interim procedures for use until the management information system was completed and to work with EQI and Arab Bank programmers on programming, installation and training issues. Reporting requirements for the systems were also established. Delays in developing the Arab Bank system became evident during the second quarter, and delays in reaching reporting functionality continue.

E1. Performance Reporting System and Planning Model Update

In January 1998, the planning model for the project was designed, but assumptions on which the model was based have since been revised. The model was also intended to be an interim tool, which would be replaced by an annual plan model integrated into each bank's budget and performance reporting system. Extensive revisions, especially in its loan portfolio projection section, were needed to make the model reflect the current reality enough to be useful.

Similarly, the performance reporting system used during 1998 was a model intended to be replaced with a system integrated into the management information system of each bank. It relies on each branch manually filling out loan, income and expense data on forms and sending them to the Chemonics office in Ramallah each month. At the office, the data are input to the model and reports are printed and sent back to the banks. The model needed the same type of update as the planning model and, having been designed for the first year only, needed revision to handle 12 months of loan activity.

Neither bank seems to do planning and reporting of its financial results on a product basis, so it may not be possible to integrate the planning and performance report models covering the microloan product into each bank. Bank of Jordan has hired an administrative person to support its program manager. Reportedly, he will be responsible for gathering and, perhaps, inputting financial performance and planning data.

In December Mr. Post revised the performance reporting system that he had developed in May. He also revised the planning model to accommodate changed requirements. The revisions required were more extensive than had been anticipated and required data for the related development of a 1999 business plan. However, the data were not provided. The revision will be completed during Mr. Post's next consultancy. Also planned is training the Massar finance and administrative specialist and, possibly, training the Bank of Jordan administrative person in the use of the models.

E2. Bank of Jordan

Delivery of the EQI software was anticipated per the subcontract in three stages:

- Stage 1: single-currency loan-tracking system
- Stage 2: multicurrency loan-tracking system
- Stage 3: reporting functionality

EQI completed the work required to add the multicurrency function in early July, three months ahead of schedule. The system was delivered with a number of reports, including a list of loans with payments falling due within a certain date range and an FLO performance report (although not in the exact format desired).

In the second and third quarters, the resident advisor provided EQI with a list of reports required and draft formats for the highest priority reports. He also visited EQI in Cairo to review and redesign all existing system reports and to test the new and revised reports.

In the fourth quarter, the final revisions for stage 3 were completed and EQI programmers installed the new software and database files. This task completed EQI's systems development and installation work. A bug in the system that caused miscounting of repeat loans was identified, but fortunately Amr Khilfer and the SLO from Hebron were able to go to Cairo and meet with EQI during the week that they were at ABA. Mr. Khilfer obtained detailed instructions from EQI and diskettes with the necessary patch to fix the bug, and installed the correction in Nablus and Hebron. Minor problems, for example, the inability to adjust a payment date set on a holiday, still exist but seem easily solvable.

The EQI system reports need to be reviewed and discussed with the bank's management to see if further modifications are needed, such as changing the portfolio-at-risk report to reflect requirements of the Palestinian Monetary Authority (PMA). Also needed are integration of the microloan system into the new Bank of Jordan system and networks to allow more than one person to access the system at each branch. Still to be delivered is the software to allow central processing of data from each branch and the systems manual.

E3. Arab Bank

Arab Bank has continued to be extremely slow in finishing the MIS program to provide the reports required. During the fourth quarter, the resident advisor met more than a dozen times with the bank's programmer to review and encourage his progress. He found numerous errors in the FLO performance report, but it was finally corrected. It joins the three reports previously available: list of loans with payments falling due within a certain date range; repayment schedule for each new loan (attached to the loan agreement); payment history by client loan. Three additional report formats were forwarded to Arab Bank: portfolio-at-risk report, client status report, and management report; however, they have not been completed. The format of the portfolio-at-risk report also must be revised to be in line with PMA requirements. A number of additional reports will also be required; however, the aforementioned reports pending are highest priority.

The reporting problem at Arab Bank is unclear. In spite of dramatic progress in other areas, little progress has again been made this quarter. Unless progress is made soon, there will be unnecessary risks for the program. Chemonics is continuing to make this a high priority and will work strongly with Arab Bank to help encourage completion of the necessary programming. Working with Arab Bank to resolve these problems will continue to require a substantial amount of analysis and persuasion from resident and short-term advisors. A systems manual and training are also needed.

F. Portfolio Growth and Loan Quality

F1. Number and Value of Loans

From June until year-end, Arab Bank disbursed 309 loans totaling \$694,399 and Bank of Jordan disbursed 447 loans totaling \$890,421. During the fourth quarter alone, the banks made 368 loans with a value of \$825,485. As of December 31, there were a combined 627 outstanding loans totaling \$870,692. December loans are an exception to the monthly increases because half of the FLOs were in training in Egypt and because the holidays and a high level of disturbances, especially in Hebron, limited demand. The growth of the loans by branch and month is illustrated in Annex C. As of the end of December, only one loan was more than 30 days past due. Overall, these are impressive results.

However, as shown in the performance monitoring reports, the cumulative loan volume for both banks is substantially below the projections that had been made for the first 7 months of credit operations (an actual 756 loans totaling \$1,584,821 versus the projected 1,876 loans totaling \$3,572,000). The larger and longer maturity second-cycle loans now starting will accelerate the growth of loans outstanding and increase the total made each month. Some variances from the original plan for the amount and length of first-cycle loans have also affected the totals. The revised FLO incentive system, as well as a new SLO incentive system for Bank of Jordan to be introduced in February 1999, should further spur growth.

The expansion of the program to new branches at Bank of Jordan, and possibly at Arab Bank, also will speed the growth of total volume and outstanding loans. During the fourth quarter, the banks have improved their approval processes. Bank of Jordan has had fast credit approval even for first-time borrowers, and Arab Bank has initiated new procedures to speed its process. The process will also be faster for the second-cycle loans now starting. The branches averaged only five new loans per FLO each month during 1998, but are planning to have each FLO make 10 or more per month in 1999. (Nablus was an exception, averaging eight new loans per FLO.) Exhibit 1 shows the average performance per FLO from June through December.

Exhibit 1. Portfolio Performance by FLO

Monthly averages across 7 months	Loans - Comparative Data					
	<i>Al Bireh</i>	<i>Bethlehem</i>	<i>Nablus</i>	<i>Hebron</i>	<i>Arab Bank</i>	<i>Bank of Jordan</i>
Avg. number FLOs	4	4	5	6	9	11
Number new loans per FLO	5	5	8	5	5	6
Amount new loans per FLO (U.S. dollars)	11,7045	10,819	13,601	10,883	11,274	12,165
Avg. amount each new loan (U.S. dollars)	2,242	2,192	1,803	2,231	2,222	1,982
Interest income per FLO (U.S. dollars)	646	510	743	510	580	623
Net loan income per FLO (U.S. dollars)	497	383	494	406	441	449

F2. Delinquencies

Although borrowers being a few days late is common, lenders must take special care to deal quickly with past due payments. Loans are considered at risk if their payments are not made within 30 days. Special-loss provisions based on a percentage of the loan must be made for loans at risk, with the percentage increasing based on the number of days past due. For example, the PMA requires a 10 percent provision for loans over 30 days past due, 20 percent for loans over 90 days, 50 percent for loans over 180 days, and 100 percent for loans over 360 days. The banks are more conservative and have higher provisioning rates for shorter periods past due.

The performance of all branches in the program has been excellent with no loans at risk reported from the start of lending until the end of December, when Al Bireh had a payment for a \$1,333 loan become 31 days past due.

All branches take immediate action whenever a loan becomes past due. FLO incentives, based largely on the loan repayment rate for their clients, encourage this performance. For the Al Bireh past-due loan, both the SLO and branch manager have taken strong action and expect the entire balance to be repaid before February. This loan equals only 0.08 percent of the total amount lent under the program, a very good record that should reassure conservative bankers concerned about the risk of microloans.

However, the lack of loans at risk must be carefully monitored. It is normal for delinquencies to rise a bit after the first cycle, and it is important to be sure that real delinquencies are identified immediately so that corrective action can be taken. Loans potentially at risk that are not identified early, are more likely to become candidates for write-off when their delinquency becomes obvious. Bank of Jordan, especially at Nablus, seems to be very aggressive in acting immediately at any hint of potential delinquency. Arab Bank has an on-line branch loan system that allows credit managers at the Regional Office and Amman to check the status of past-due loans. It also acts quickly when a payment is late. Arab Bank is also creating a special loan-loss reserve within its microenterprise lending to assure senior management that microloans represent little risk.

G. Financial Performance

The banks are starting to see the profits needed to convince them that the microloan business is sustainable and should become a standard bank product. Arab Bank's recent strong action to solve many issues slowing the development of the project may be one indication of the impact of the financial results.

For every month in the fourth quarter, each of the four branches made a profit, after USAID payments for FLO services. Further, both banks are less than \$10,000 from breakeven after payment of the USAID progress payments. If Arab Bank had received both the \$35,000 progress payment and the claim for MIS development, it would have made a small profit in 1998. Both banks should break even soon, after USAID payments. More important, they should break even without *counting* USAID support long before that support ends.

The interest rates for the loans are charged on a flat rate high enough to cover the cost. The interest income projected in the 1998 plan was based on the new borrower U.S. dollar rate. For Arab Bank, this projection was accurate because over 90 percent of the bank's loans were made in dollars (90 percent for Al Bireh and 96 percent for Bethlehem), but for Bank of Jordan the actual interest rate was higher. At Nablus most of the loans were in Jordanian dinars; at Hebron only 71 percent of the loans were in dollars while 23 percent were in NIS. In total, 59 percent of the loans were made in dollars, 31 percent in JD and 10 percent in NIS. The trend is away from NIS loans because of the fall in the currency's value. The rates charged on program loans are as follows:

	U.S.\$	JD	NIS
New borrowers	1.75%	2.00%	2.50%
Repeat borrowers	1.50%	1.75%	2.25%

Net loan income is close to or better than projections, even though loan volume and interest income are much lower than projected. This is because the provisions for loan losses have been much lower than planned. As a result, net loan income for the 7 months is only \$3,945 less than projected for Arab Bank and \$49,607 higher than projected for Bank of Jordan.

Costs have also been lower than projected. The branch costs are much lower than those projected, primarily because there are fewer FLOs than planned. At Arab Bank, the actual costs were much lower because cost data were not available during the planning exercise, which resulted in very conservative estimates. Both banks have had much better than expected financial results during the start-up months. Exhibit 2 summarizes the variances from the original plan.

Exhibit 2. Variance in Financial Performance from the Original Plan (U.S. Dollars)

Arab Bank	June - Dec Plan	June - Dec Actual	Variance
Interest income	98,352	35,079	(63,273)
Expenses			
Cost of funds	(15,974)	(4,738)	11,236
Loan-loss provision	(55,995)	(4,398)	51,597
Branch costs	(234,654)	(109,330)	125,324
Regional management costs	(98,580)	(34,993)	63,587
Total expenses	(405,203)	(153,459)	251,744
Profit/loss before USAID	(306,851)	(118,380)	188,471
USAID payments	232,322	72,751	(159,571)
Profit/loss after USAID	(74,529)	(45,629)	28,900

Bank of Jordan	June - Dec Plan	June - Dec Actual	Variance
Interest income	98,350	44,502	(53,846)
Expenses			
Cost of funds	(15,977)	(8,920)	7,057
Loan-loss provision	(100,014)	(3,616)	96,398
Branch costs	(192,175)	(155,450)	36,722
Regional management costs	(123,168)	(103,028)	20,139
Total expenses	(405,203)	(153,459)	251,744
Profit/loss before USAID	(332,983)	(226,515)	106,470
USAID payments	321,322	218,833	(102,489)
Profit/loss after USAID	(11,661)	(7,682)	3,979

G1. Sources and Uses of Funds for the Program

During the first year, USAID payments (for FLOs, MIS and related cost plus the preset progress payments to the banks) totaled \$218,833 for Bank of Jordan and \$72,751 for Arab Bank. According to Arab Bank, it has not received progress payments or reimbursement for MIS development. Reportedly, the first \$35,000 payment will be made soon, and a claim for MIS cost reimbursement is pending.

The actual USAID payments for branch expenses (FLOs, etc.) covered 57 percent of Bank of Jordan's branch expenditures on the program and 67 percent of Arab Bank's. Total USAID payments covered 85 percent of Bank of Jordan's direct operating expenses (branch and regional management) and 51 percent of Arab Bank's. If the expenses for loans-loss provisions and cost of funds are added to direct operating cost, USAID covered 81 percent of Bank of Jordan's seven-month cost and 47 percent of Arab Bank's. The USAID funding is designed to cover most of the start-up cost to encourage the banks to start microloan programs.

Since the funds used in the loans are from the banks' normal funding pool, they are essentially borrowed from depositors at the cost needed to get deposits. Funding from USAID and from the profits of each bank were used to cover the normal and special start-up cost of the project, including the cost of the funds lent to the microenterprises.

H. Research and Evaluation

Beyond the initial institutional diagnostic evaluation of the two banks, activities in research and evaluation were limited until the fourth quarter to the baseline market survey completed in May by Massar Associates. That initial survey helped to define the market and the needs of potential borrowers, and helped finetune the program's policies and procedures.

Starting in October, Chemonics specialist Jorge Daly conducted a full evaluation of the program. This work essentially served as an early mid-term evaluation and had been originally timed to coincide with the change of resident advisor. Its purpose was to:

- Evaluate the progress of the banks in implementing microlending best practices, building their loan portfolios, and reaching financial breakeven and sustainability.
- Identify and evaluate the issues critical to ensuring that the banks incorporate microlending into their regular business.
- Prepare a survey of existing borrowers to develop a clear profile of clients served.

Under Mr. Daly's guidance, Massar Associates conducted the borrower survey.

H1. Evaluation of the Microenterprise Lending Program

This section discusses the evaluation's findings and recommendations.

The banks have initially been very conservative in developing this program. That is understandable as they are hierarchical, bureaucratic organizations headquartered outside the West Bank; lend their own money; and operate in a volatile, multicurrency, and unregulated market. Furthermore, until now, they had been inexperienced in lending to microentrepreneurs. Given the limitations of their conservative policies, banks have made an excellent start in expanding their loan portfolios, with only one loan at risk.

The banks must accelerate the growth of loan disbursement while maintaining the excellent repayment rates. Chemonics and the USAID mission need to persuade key bank managers to change the policies blocking the planned expansion of a sound portfolio. They must be fully convinced that microloan best practices create low-risk, profitable business for their banks. To do this, the evaluation recommends that a deputy resident advisor be hired to advise bank branch personnel on implementing best practices, freeing the resident advisor to focus on persuading the senior managers to make important changes in policies and procedures.

The banks rely too much on guarantors to reduce loan risk, and in some cases have very stringent requirements for acceptable guarantors. This hurts the program by adding unnecessarily to processing time and excluding potentially good customers. The evaluation recommends that guaranty requirements be gradually relaxed and that alternative methods to reduce loan risk, such as interest rebates for early repayment, be considered.

The banks have given many of their loan approvals to applicants in the upper tier of the micro-enterprise market. If the program focuses on this segment, the loan products need to be redesigned. Equally important, other microenterprise market segments, including smaller, unlicensed businesses, may not be adequately served. The borrower survey provides data supporting this view. The evaluation recommends that a new baseline survey be made to determine the loan demand profile of different segments of the microloan market to allow design of appropriate loan products.

Field loan officers are overburdened with administrative tasks, claim that they do not have needed support from the banks, and are uncertain of their current status within the banks and their future as career bank employees. These issues must be clarified. The ABA training and eventual availability of a good management information system will help lessen the FLO's burden. Problems with transportation expense coverage are also being dealt with. The evaluation recommends that a plan be developed with the banks on the criteria and timing for transferring FLOs to permanent bank employment, including the issues of pay and position. This will free program resources for expansion and hiring of other FLOs. The evaluation also recommends a survey of FLO, SLO and branch manager satisfaction with the program and their relationships.

Consolidation and sustainability of the program requires more intensive training of the SLOs and branch managers, completion and full installation of program MIS, and subsequent transfer of loan approval authority to the branches. MIS implementation has been too slow, especially at Arab Bank. Particularly as loan volume grows, this delay adds to the administrative burden, increases processing cost, and makes it more difficult to quickly detect and correct problems.

Recommendations include giving the branch personnel responsible for microlending more exposure to best practices and encouraging the banks to promote those personnel who are most successful in the microlending business. The evaluation recommends that Chemonics and USAID pressure the banks to finalize program MIS and to transfer lending authority when the training and MIS are completed.

The chances for success are better if microlending is treated as a separate profit center. Once the program has been firmly established within the banks, the evaluation suggests that the banks create a separate subsidiary for the microloan business to avoid culture clash and conflict in procedures. It also recommends that the program pay close attention to the PMA's development of the bank regulatory requirements and encourage within that framework licensing of entities with smaller capital requirements.

Finally, the evaluation compliments the responsible managers at Bank of Jordan on their leadership in developing the program and expresses concern about what would happen if these key individuals were transferred. It recommends strong assistance in the bank's expansion of the microloan business. It also notes less progress at Arab Bank and recommends a strong collaborative effort between Chemonics and the USAID COTR to persuade senior bank management to modify inhibiting policies and significantly increase loan output. Mr. Post and subsequently the USAID COTR discussed with the banks specific recommendations for their operations.

H2. Microenterprise Borrower Survey

The survey of borrowers covered 105 businesses, or 20 percent of the clients. It strongly supports some of the evaluation's findings. Many borrowers are clearly in the upper tier of the microenterprise market, with 27 percent having working capital needs of more than \$9,000 and 40 percent identifying their optimal loan size as over \$10,000. Only 38 percent said that they were satisfied with the current size of their loans. Under the current program, initial loans start at about \$2,000 and increase in progressive cycles, after repayment of each loan, to a maximum of \$10,000.

Only 13 percent of all respondents reported having prior access to bank credit. If 40 percent of the clients need more than the maximum \$10,000 loan offered, then most are not currently able to get what they need from banks. This supports the recommendation that new loan products need to be designed.

Thirty-three percent of Arab Bank's respondents and 19 percent of Bank of Jordan's respondents reported dissatisfaction with the speed of loan approvals. This supports the evaluation's findings on the relative progress of the two banks. At Arab Bank, 12 percent had difficulty getting a guaranty, while only 6 percent of Bank of Jordan borrowers reported a guaranty problem. Most, 75 percent, were satisfied with the repayment period, but only 51 percent were satisfied with the interest rate.

I. Recommendations for Participating Banks

The following are recommendations made and their status:

Service

Recommended: Improve the service to clients, particularly the time required to review, approve and disburse loans.

Status: Bank of Jordan has continued to approve loans quickly, and Arab Bank began implementing major improvements at the end of the fourth quarter.

Incentives

Recommendation: Expand the incentive system to include SLOs.

Status: Bank of Jordan has recommended that its general management approve the incentive system for SLOs that the resident advisor proposed. Arab Bank still believes there is little chance for such an incentive system to be approved.

Decentralization

Recommendation: Decentralize credit decisions to the branch offices to improve service and increase accountability of the branch offices.

Status: Bank of Jordan agreed to consider such a decentralization of some credit decisions but has not yet done so. Arab Bank has not moved toward decentralization but has moved to minimize the delays involved in its centralized process.

Collateral and guarantees

Recommendation: Follow the guarantor requirements agreed to by the banks before the commencement of lending and included in the operating manuals. Under these requirements, one guarantor was to be required for all loans and was to be known by and acceptable to the bank but not required to open an account at the bank. Bank managers need additional technical assistance and training plus exposure to microfinance programs that do not depend to such an extent on guarantees.

Status: Both banks often require more than one guarantor or that a guarantor open an account at the bank. Banks occasionally require the deposit of salaries. The Bethlehem branch manager continues to insist that he know the guarantor personally.

SLO dedication to activity

Recommendation: SLOs at the branches of Bank of Jordan and Arab Bank should be 100 percent dedicated to the microenterprise activity.

Status: Bank of Jordan's Nablus and Hebron SLOs are now dedicated 100 percent to this activity. Arab Bank has now appointed an assistant SLO at Al Bireh who is 100 percent dedicated, but the senior SLO there still spends only 20 percent of his time on this activity. The Bethlehem SLO also spends most of her time on the project.

Administrative support

Recommendation in July: All branches involved provide administrative support to this activity.

Status: The branches still have not provided dedicated administrative support, but new computers, supplied by the program, will allow FLOs to access information and the loan system themselves, easing the administrative burden. Bank of Jordan has discussed adding administrative support as the volume and profits grow. Bank of Jordan is also adding a dedicated administrative person at the regional office to support the program and its personnel. The Al Bireh assistant SLO takes on some of this burden.

Space

Recommendation in July: Bank of Jordan's Hebron branch and Arab Bank's Bethlehem branch should provide better workspace for the FLOs.

Status: Hebron FLOs may be moving to another space outside of the branch. Bethlehem FLOs have been moved to improved, but temporary, space.

MIS

Recommendation: Arab Bank *must* dedicate the resources required to complete the system reporting requirements.

Status: There was no significant progress in the fourth quarter.

Performance monitoring system

Recommendation: Arab Bank needs to provide the required cost information in a more timely manner so that progress can be evaluated as soon after the end of the month as possible.

Status: There was progress at the end of the quarter, as the reports became more important to management.

Planning

Recommendation: Both banks need to go through a planning process for the next calendar year and beyond and prepare revised business and financial plans (with the assistance of or even led by Chemonics personnel). The planning process should include the participation of the FLOs, SLOs, branch managers and regional managers. The modified business plans must be embraced by all those involved with the microenterprise loan product, and actual performance plan must be rigorously evaluated.

Status: Detailed discussions were held with regional management of both banks in December and with SLOs in Nablus and Al Bireh. Required information from the banks is still missing, but the planning exercise will be completed early in the first quarter of 1999.

Technical assistance and training will continue to be provided (and pressure applied when appropriate) to implement all recommendations.

ANNEX B to Annual Progress Report for 1998	
West Bank/Gaza Microenterprise Lending Activity	
First Year Work/Implementation Plan Status	
Activity	Comments/Status
Activity Administration	
Establish IC Office	Completed
Complete recruitment local staff	Completed
Complete procurement for IC team	Completed
Install accounting/administration programs	Completed
Prepare/submit life-of-contract Implementation Plan	Completed
Prepare/submit 1st Annual Workplan	Completed
Prepare/submit Quarterly PMRs	Completed
Activity Implementation	
Complete MOUs with PBs	Completed
Develop FLO recruitment criteria, FLO/SLO job descriptions	Completed
Team Building/Planning Sessions (with USAID, within IC team)	Completed
Promotional Workshops	Completed
Project Review Workshops with PBs/USAID	On-going
Organize Microenterprise Forum	Pending
Microenterprise Forum Meeting	Pending
Technical Assistance	
Select participating branches	Completed
Conduct institutional/financial diagnostics of PBs	Completed
Stage I Recruitment of FLOs	Completed
Develop/finalize incentive scheme	Completed
Workshop: Loan Pricing, Cost and Performance Analysis	Completed
Workshop: Strategic Planning/Business Development	Completed
Conduct cost analysis on loan portfolio	Completed
Prepare loan documentation	Completed
Review/modify lending procedures	Completed
Develop/produce operations manuals	Completed
Workshop: Publicity Campaigns	Pending
Stage II Recruitment (FLOs)	Pending
Monitor loan portfolio performance	On-going
Review Personnel Policies/Procedures	On-going
Prepare/Distribute Policy Papers	Pending
MIS	
Perform systems diagnostics	Completed
Identify data requirements/assess software options	Completed
Prepare/submit microcredit system recommendations	Completed
Develop/install software applications	Installations completed, reporting functionality pending
Prepare documentation/program manual	Pending
Develop/deliver user training program	Completed
Data management (on-going)	On-going
Training	
Prepare/finalize Year 1 master training plan	Completed
Deliver Module 1: Introduction to Banking	Completed
Deliver Module 2: Principles of Credit	Completed
Deliver Module 3: Microenterprise Lending	Completed
Bank internships	Completed
Workshop: Basics of Microlending	Completed
Research and Evaluation	
Baseline Survey and Market Analysis	Completed
Study: Extending Microcredit to Women	Pending

ANNEX C TO 1998 ANNUAL PROGRESS REPORT						
LOAN GROWTH BY MONTH 1998						
	June	July	Aug	Sep	Oct	Nov
Number of New Loans this Month						
Nablus	27	36	28	38	50	56
Hebron	13	18	29	35	31	29
Al Bireh	15	21	26	31	26	26
Bethlehem	19	20	17	15	19	28
Total	74	95	100	119	126	139
Amount New Loans for the Month						
Nablus	49,930	61,690	49,155	66,338	91,831	101,887
Hebron	25,556	36,500	63,613	75,161	75,251	69,982
Al Bireh	28,778	42,002	52,279	66,081	55,778	73,836
Bethlehem	38,140	40,113	34,000	30,000	40,000	66,667
Total	142,403	180,304	199,047	237,580	262,859	312,373
Number of Active Loans						
Nablus	27	63	90	129	177	231
Hebron	13	31	60	95	126	149
Al Bireh	15	36	59	86	111	112
Bethlehem	19	39	56	71	94	110
Total	74	169	265	381	508	602
End of Month Outstanding						
Nablus	48,521	101,362	131,903	170,746	225,558	275,827
Hebron	25,556	56,993	107,146	160,333	202,073	229,846
Al Bireh	28,778	63,474	98,989	139,175	154,743	187,186
Bethlehem	38,140	73,243	94,881	106,686	13,675	150,547
Total	140,995	295,072	432,919	576,942	596,049	843,406
Cumulative Number Loans Made						
Nablus	27	63	91	129	179	235
Hebron	13	31	60	95	126	155
Al Bireh	15	36	62	93	119	145
Bethlehem	19	39	56	71	90	118
Total	74	169	269	388	514	653
Cumulative Amount Loans Made						
Nablus	49,930	111,620	160,775	227,113	318,944	420,831
Hebron	25,556	62,056	125,668	200,829	276,080	346,063
Al Bireh	28,778	70,779	123,059	189,140	244,917	318,754
Bethlehem	38,140	78,253	112,253	142,253	182,253	248,920
Total	142,403	322,708	521,755	759,335	1,022,194	1,334,567

Dec		
29		
28		
27		
19		
103		368
55,211		
68,316		
71,500		
54,000		
249,027		824,260
260		
183		
121		
113		
677		
256,321		
248,493		
198,942		
162,218		
865,974		2305428.4
264		
183		
181		
137		
765		
476,042		
414,379		
383,550		
300,625		
1,574,596		

West Bank/Gaza Microenterprise Lending Activity
Preliminary Second Year Workplan (Qtr 1)
Annex D, 1998 Annual Progress Report

Task										Year 2 (3 month projection)			Comments
										Jan-99	Feb-99	Mar-99	
Activity Administration													
Prepare/Submit Annual Progress Report													
Prepare/Submit Quarterly Report													
Prepare/Submit Preliminary Year 2 Workplan													
Prepare/Submit Final Year 2 Workplan													
Recruit New Resident Advisor													
Recruit Deputy Resident Advisor													
End of Year 2 Retreat													
Prepare/Submit Completion Report													
Activity Implementation													
Team Building/Planning Session (new team)													
Revise Bank of Jordan MOU for Expansion													
Project Review Meetings with PBs and USAID													On-going periodically
Organize Microenterprise Forum													
Microenterprise Forum Meetings													
Technical Assistance													
Revise Operating Manual													Consultant
Integrate Operating Manual in PB Std Ops Procedures													
Incentive System (FLO/SLO) Changes Implemented													
Develop/Gain PB Agreement on 1999 Financial Plan													Consultant
Implement Program Expansion to Jenin & Gaza													
Phase 2 FLO Recruitment													
Phase 3 FLO Recruitment - Arab Bank													
Implement Evaluation Recommendations													
Prepare/Present Policy Briefings to PB Management													
Review/Modify Lending Procedures													
Monitor Loan Portfolio Performance/Portfolio Reviews													on-going
Workshop: Review of Expansion & Sustainability													
Second Review/Adjustment of Lending Procedures													
Review Personnel Policies/Procedures													On-going
Review Internal Controls and Propose Changes													
Monitor Financial Performance													On-going
MIS													
EQI Bank of Jordan System Manual Completed													
Arab Bank Reporting Completed													
Arab Bank System Manual Completed													
Data Management													On-going
Review linkage/reconciliation between EQI and BJ system													Consultant
EQI-Bank of Jordan multi-user issue analyzed													Consultant
Bank Performance Monitoring Model Revised for 1999													
Bank Performance Monitoring System Implemented at PBs													
Training													
Create Training Plan for New FLOs													Consultant
Senior Management Exposure Trip (to Chile)													
FLO/SLO Exposure Trip to Egypt													
Phase 2 FLO Training													
Performance Evaluation: Phase 1 & 2 FLOs													
Training of Trainers Course													
Research and Evaluation													
Study: Extending Microcredit to Women													
Supply Side/Demand Market Study - Microfinance													
Study of Legal/Regulatory Constraints to Micro-lending													